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TO RUEHC/SECSTATE WASHDC 7277
RHMFIUU/DEPT OF ENERGY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC
INFO RUEHKS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHKO/AMEMBASSY TOKYO 1252
RUEHBY/AMEMBASSY CANBERRA 1699
RUEHBJ/AMEMBASSY BEIJING 4554
RUEHUL/AMEMBASSY SEOUL 4323

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SUBJECT: Coal Update-Blue Skies for Black Coal in Indonesia

Ref: Jakarta 2095 (Indonesia's Coal Output Increases)

11. Summary. Indonesian coal producers are enjoying boom times thanks to high global prices driven mainly China's new net importer status.

Production is tipped to rise a modest three percent, however. With bench mark prices up 64 percent this year and global supplies tight, international coal buyers are scrambling to assure supply. Early monsoon rains are the only threat to increased production, but higher prices are likely to more than compensate for reduced volumes. Heavy rainfall in the last three months has done little to hurt overall output but has hindered companies from expanding in response to record prices. Our contacts told us they foresee steady growth in overall production, exports, and profits for the near term. The GOI is sending mixed signals on its export and domestic supply policies. End Summary

12. (SBU) Indonesia is on track to produce 198 million metric tons (MT) of coal in 2007 and has produced 143.5 MT valued at \$4.6 billion during the first three quarters, said Minister of Energy and Mineral Resources Yusgiantoro Purnomo in a press conference on November 29. Indonesia produced 192 MT in 2006, according to GOI statistics, and became the world's largest thermal coal exporter in late 2006/early 2007. It has estimated reserves of around 40 billion tons. Our contacts say coal production for 2008 will likely be between 225 and 235 MT with exports likely to surpass modestly 2007's estimated total of 155 MT driven by increasingly strong domestic demand. The GOI is seeking to build 35 new coal-fired power plants generating 10,000 MW of electricity by 2010, which will require state electricity firm PLN to double its coal demand to 70 MT per year.

Policy Murk: Export Tax? Quota? DMO?

13. (SBU) On December 5, Director General of Coal Simon Sembiring told reporters that the GOI will limit coal exports to 150 million tons a year through 2025 to meet surging demand from domestic buyers. We spoke with the Ministry's Coal Director M.S. Marpaung, who works for Semibiring, also on December 5. He denied that the GOI will impose export quotas. He said a domestic market obligation for coal is already a long-standing feature of coal contracts of work, but added that Indonesian production and reserves are currently plentiful. He noted that current domestic demand at 49 MT per year is far below production leaving plenty of room for exports now and in the future. The policy is meant to reassure domestic users and potential power investors that the GOI will provide for their energy needs, according to Marpaung. GOI contacts tell us

they estimate coal output will rise nearly 11 percent next year as producers increase capacity. Indonesia will consume 75 and 90 MT of coal in 2009 and 2010, respectively, according to GOI contacts.

14. (SBU) During a meeting with a visiting department analyst on November 27 Marpaung said the GOI is considering several measures to support increased coal production, including halving the royalty levied on low-quality coal. The Ministry of Energy and Mineral Resources (MEMR) has proposed a plan to the finance ministry to offer a 6.5 percent royalty for low-rank coal developers, according to Marpaung. Current coal contracts of work require Indonesian producers to pay the GOI a royalty of 13.5 percent. This royalty would be unchanged for higher-grade coal, almost all of which is exported. The GOI considers coal with a heat value lower than 5,100 kilocalories per kilo to be low-rank. Marpaung also denied the GOI is considering a 5 percent export levy on coal, but a wide cross section of contacts in meetings on November 27 and 28 suggest otherwise.

15. (SBU) Marpaung's comments also betrayed a GOI bias toward economic nationalism in the coal sector. He told us, "There will be no more KPCs," referring to the 35 MT per annum Kal Prima Coal company in East Kalimantan, which is the crown jewel for the leading coal producer PT Bumi Resources. Instead, he said the new GOI policy will be to limit the size of coal exploration areas so that ten companies will be producing 5 MT per year, rather than one producing 50. When asked about efficiency concerns and the desire to maximize GOI royalty revenues, Marpaung shrugged and said that the cost of mining in China is three times that of Indonesia. Nonetheless, William Deertz of PWC's Mining and Energy Consulting practice told us that having 10 companies instead of one in a conventional contract area will cost lots of time and money for producers and depress the GOI royalty stream.

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Producers in Driver's Seat

16. (SBU) Many of our contacts commented that strong coal demand is also forcing world thermal coal importers to re-assess their benchmarks. An executive with Indonesia's number two producer PT Adaro told us that even five years ago many buyers insisted on coal with 25 percent moisture content or less and a minimum 5,500 per kilo caloric value or higher. Now, he said even Japanese and Korean importers, who were historically quite stringent in their specifications, are willing to consider coal with up to 35 percent moisture content. Marpaung said his next goal is to get more international buyers besides Indians accustomed to buying 40 percent moisture coal for blending. Driving much of this frenetic activity is the rapid growth of power demand in southern China, enormous power infrastructure building in India, and continued strong growth in Vietnam and Thailand, according to industry and GOI contacts. This new growth is also competing with continued high levels of demand from Japanese and Korean power producers. Both Bumi and Adaro contacts told us they are convinced they have the resource base and customer demand to raise their respective production levels to 100 MT per year in the next decade.

Hot Sector Draws Investor Cash

17. (SBU) On November 30 Bumi announced a \$1 billion bond offering for 2008 to raise funds for capital expenditure, according to the financial press. Bumi executive Peter Ball told us on November 28 that Bumi is seeking to double production capacity to 100 MT in 2011 from 50 MT in 2006 and will require an expanded financing base. Also, in late November the Indonesian unit of Thai coal miner Banpu PCL, PT Indo Tambangraya Megah, has taken advantage of the global coal scramble to announce an IPO on December 17. Company executives say the IPO target price range will value Indo Tambangraya Megah at around \$1.7 billion, making it Indonesia's third largest listed coal miner by market value, after Bumi Resources and Bukit Asam.

18. (SBU) Adaro, the country's second-biggest coal mining firm by

volume, is contemplating a \$600 million IPO in early 2008, according to press reports. We met with Adaro executives on November 27 and they refused to confirm or deny such a plan, saying merely that they had several interesting options. They were similarly cagey on a November 26 press report that China's largest coal producer Shenhua Energy will make a \$4 billion takeover bid. Adaro is controlled by the Soeryadjaya family, former owners the Astra automotive group, and 36 percent-owned by investors including Goldman Sachs, Citi, and a San Francisco-based hedge fund, according to Adaro executive Alastair Grant. With four deposits in South Kalimantan and a total reserves of 3 billion tons of low-sulphur coal (0.2 percent or less), Adaro is targeting output 40 MT in 2008 and 100 MT by 2017, said Grant.

Rains Hamper Output Expansion Plans

19. (SBU) In late November a regional investment analyst predicted that Indonesian coal production may be reduced by as much as 25 percent in 2007 because of excessive rain. Bumi, Banpu, and Straits Asia Resources Ltd. may have lost up to 20 MT in the second quarter and third quarter, according to the analyst's note. Our Bumi contacts said output went down a few percent in October and November but shrugged off any concerns on reduced volumes, saying higher prices would more than make up for any shortfalls. Banpu and Straits did declare force majeure in July and August due to the rains, but Adaro contacts told us the company was still meeting its monthly production target. All our contacts do agree that heavy rains have hampered expansion plans to take advantage of the current high selling prices. The West Monsoon rains in Kalimantan, which typically begin in December and last to March, started this year in early November.

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